

In Brief

February marked a period of consolidation in U.S. equity markets following the strong rally at the start of the year. While headline indices remained relatively resilient, underlying dynamics showed increasing dispersion across sectors, driven by interest rate expectations, earnings revisions, and positioning after a concentrated advance in large-cap technology stocks. Major U.S. indices delivered mixed performance during the month. The S&P-500 traded largely sideways (-0.76%), with gains in defensive and cyclical sectors offsetting weakness in high-growth segments. The Nasdaq Composite underperformed, reflecting continued pressure on technology and AI-related stocks, while the Dow Jones Industrial Average showed relative strength due to its higher exposure to industrials and financials. Interest rate expectations remained a dominant driver of market behavior. Stronger-than-expected economic data, particularly in employment and services, led to a repricing of Federal Reserve policy expectations. Markets increasingly priced a 'higher for longer' interest rate environment, which weighed on long-duration assets such as growth equities. At the same time, productivity gains and resilient consumer spending continued to support the broader economy, reducing immediate recession risks but limiting the scope for aggressive monetary easing.

Economy

February 2026 was characterized by continued economic resilience in the United States, accompanied by persistent inflationary pressures and a reassessment of monetary policy expectations. The macroeconomic environment remains supportive of growth, but the path toward lower inflation has proven slower than anticipated. Consumer spending remained robust, supported by a strong labor market and rising real incomes. The services sector continued to expand, while manufacturing showed signs of stabilization after a prolonged period of weakness. However, the strength of economic activity also contributed to upward pressure on interest rates. The labor market remained tight, with job creation exceeding expectations. Wage growth, while moderating slightly, remained above levels consistent with the Federal Reserve's inflation target. Strong employment conditions supported consumption, but also complicated the disinflation process, particularly in labor-intensive service sectors.

Labor Market

The U.S. labor market remained resilient in February, with job creation continuing to exceed expectations and unemployment staying at historically low levels. While hiring momentum has moderated, demand for labor remains strong, particularly in services, healthcare, and government-related sectors. Wage growth has gradually eased but is still running above levels consistent with the Federal Reserve's 2% inflation target, contributing to persistent services inflation. At the same time, rising productivity has begun to offset some labor cost pressures, allowing companies to maintain margins without significantly expanding headcount. Overall, the labor market continues to support consumer spending and economic growth.

Monetary Policy

In February, monetary policy expectations shifted toward a more restrictive outlook, as resilient economic data and persistent inflation led markets to reassess the timing and magnitude of Federal Reserve rate cuts. The disinflation process has proven gradual, particularly in services, while a still-tight labor market continues to support wage growth above levels consistent with the Fed's inflation target. As a result, the Federal Reserve is expected to maintain a 'higher for longer' policy stance, prioritizing price stability over near-term growth concerns. This repricing was reflected in higher Treasury yields, especially in the short and intermediate maturities, contributing to tighter financial conditions. While the broader policy direction remains data-dependent, the balance of risks has

shifted toward fewer and later rate cuts, reinforcing a more cautious environment for both fixed income and equity

Corporate Earnings

Corporate earnings in February reflected a broadly resilient, but moderate growth environment. Fourth-quarter results were generally solid, supported by continued consumer demand and stable profit margins, particularly in services-oriented sectors. However, forward guidance became more cautious, as companies highlighted persistent cost pressures, especially in labor, and a more uncertain demand outlook. Earnings growth remains positive, but the pace of upward revisions has slowed, with notable dispersion across sectors. Mega-cap technology companies continue to deliver strong absolute earnings, although valuations leave little room for disappointment, while more cyclical industries show improving fundamentals, but remain sensitive to interest rates and economic momentum. Overall, the earnings backdrop remains supportive for equities, but the combination of elevated valuations and moderating growth underscores the need for selectivity and a focus on cash flow and balance sheet strength.

Thoughts on Geopolitical Risks

The escalation of tensions surrounding Iran has emerged as a central geopolitical risk for global financial markets. The primary transmission channel is energy, as the Middle East remains critical to global oil supply, with roughly 20% of global crude flows passing through the Strait of Hormuz. Any disruption to this strategic chokepoint, whether through direct military conflict, attacks on shipping, or precautionary halts in transit, has the potential to trigger a sharp increase in oil prices, with estimates suggesting prices could rise toward or above \$100 per barrel in a severe scenario. Such an energy shock would feed directly into higher global inflation, complicating central bank policy and delaying interest rate cuts. Beyond energy markets, a sustained conflict risks broader supply chain disruptions, increased volatility across equities and credit markets, and a flight to safe-haven assets such as U.S. Treasuries and gold. While some scenarios imply only temporary disruptions, the key risk lies in escalation, including regional spillovers or prolonged instability, which could materially weaken global growth and tighten financial conditions.

Best case: hostilities de-escalate quickly into a managed standoff, with shipping through the Strait of Hormuz largely maintained and any disruptions limited to short-lived delays, higher insurance costs, and intermittent risk-off moves; in this scenario, oil prices may experience a temporary spike but stabilize as alternative supply and OPEC+ spare capacity help bridge gaps, allowing inflation to continue easing and central banks to remain on a gradual path toward future rate cuts. **Worst case:** the conflict broadens and/or becomes prolonged, leading to sustained disruption of Gulf shipping and energy exports-especially through the Strait of Hormuz, which in recent years has carried more than one-quarter of global seaborne oil trade and about one-fifth of global oil consumption, as well as a significant share of LNG trade; a material interruption would likely push oil sharply higher, revive inflation, delay monetary easing, tighten financial conditions, and raise recession risk for energy-importing economies, while also increasing the probability of wider supply-chain shocks, higher credit stress, and extended volatility across equities, rates, and currencies.

The most likely scenario in our opinion is a contained but persistent conflict characterized by intermittent escalations rather than a full-scale regional war or a rapid resolution. All major actors, including Iran, the United States, and regional powers, have strong incentives to avoid a direct and prolonged confrontation that could destabilize global energy markets and threaten domestic stability. As a result, tensions are likely to manifest through limited, asymmetric actions-such as proxy engagements, localized incidents, or temporary disruptions to shipping-without leading to sustained interruption of oil flows through critical routes such as the Strait of Hormuz. This environment would maintain a geopolitical risk premium in energy prices and financial markets, contributing to episodic volatility and slightly higher inflation, while allowing global economic growth to continue. However, the situation remains highly sensitive to escalation triggers, including direct military confrontation or prolonged

disruption of key energy infrastructure, which could materially alter the outlook.

Market Outlook

The escalation of tensions with Iran introduces a meaningful but highly scenario-dependent impact on financial markets. In the most likely case of contained conflict, markets would experience episodic volatility, with energy prices incorporating a geopolitical risk premium but avoiding a sustained supply shock. This would keep inflation slightly elevated in the United States. Equity markets would likely show increased dispersion, with energy and defense sectors benefiting, while interest rate-sensitive and high-valuation growth stocks remain more vulnerable. Safe-haven assets such as U.S. Treasuries, the U.S. dollar, and gold would see periodic inflows during periods of heightened tension. In a more severe scenario involving prolonged disruption to Middle Eastern energy supply, oil prices could rise sharply, triggering a renewed inflation impulse, tighter financial conditions, and increasing the risk of a broader economic slowdown. Overall, geopolitical risk is likely to act as a source of volatility rather than a sustained trend driver unless it materially disrupts global energy flows.

The current environment is defined by resilient growth, persistent inflation, and elevated geopolitical uncertainty. While the macro backdrop remains supportive, the combination of higher interest rates and elevated valuations reduces the margin for error. In this context, portfolio construction should emphasize selectivity, diversification, and cash flow resilience. Exposure to structural growth themes remains warranted but should be balanced with assets that benefit from higher rates and geopolitical risk, including energy and income-generating strategies. Maintaining flexibility and discipline will be critical, as markets are likely to remain driven by shifting expectations.

Your Terra Nova Team!